

# Assessing the Economic Impact of a Local Preference Ordinance in the City of Fresno

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**Dr. Antonio Avalos\***

[aavalos@csufresno.edu](mailto:aavalos@csufresno.edu)

and

**Dr. Edward Birdyshaw\***

[ebirdyshaw@csufresno.edu](mailto:ebirdyshaw@csufresno.edu)

Department of Economics  
California State University, Fresno



\* The findings, interpretations, and conclusions are the authors' own responsibility and do not necessarily represent any position of the California State University, Fresno

## **I. Introduction**

In several cities, counties, and states around the U.S., the procurement decision process contains provisions that give preference to local businesses as a means to support the local economy. One common way to give local preference occurs in the bidding process, where a jurisdiction gives preference to a local company if a bid from this business is within a certain percentage of the lowest non-local bid. The rationale behind this policy is relatively simple. Giving preference to local businesses means that a larger amount of dollars will be spent locally by the city which, as a result of the multiplier effect, will in turn result in additional sales, jobs, income, and ultimately tax revenue.<sup>1</sup> Obviously, although the basic idea is appealing from the tax revenue perspective, it is also possible that these additional benefits be only modest—or even nullified—because the city may not be buying from the lowest cost or most efficient supplier. Nevertheless, the principle of granting local preferences derives from the belief that additional dollars spent locally will generate economic activity beyond the value of the initial contract, even if this local contract implies higher costs to the city.

The main goal of this brief report is to provide an assessment of the potential benefits and costs of establishing a local preference ordinance in the City of Fresno. The ordinance under consideration would give preference to local businesses if their bids are within 5% of the lowest non-local bid. The aim is to provide a better understanding of the merits and drawbacks of implementing the local preference ordinance in the City of Fresno. Only then can policy makers, tax payers and voters, make informed decisions regarding the impact of such policy on the local economy.

## **2. Scope and Methodology**

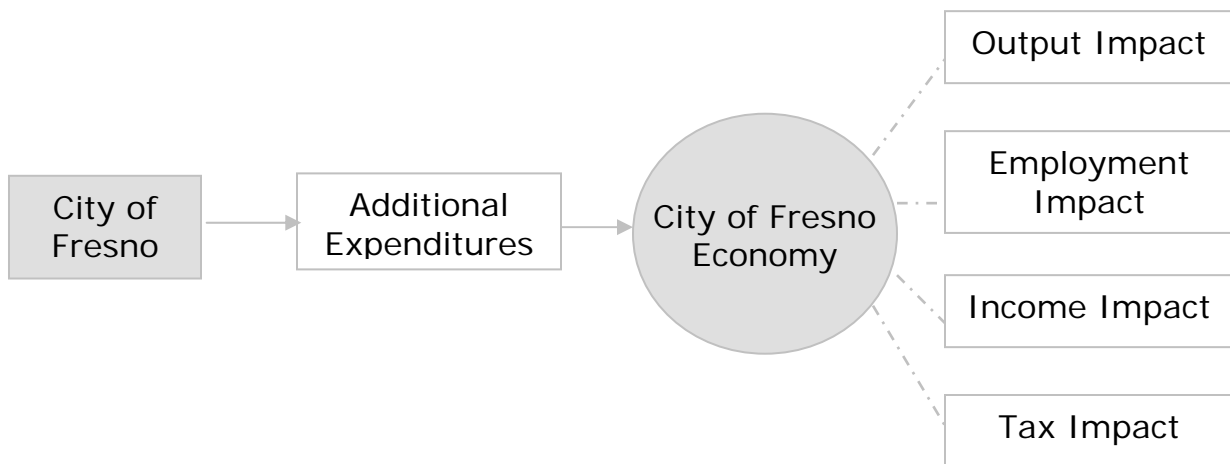
This report assesses the potential benefits and costs of establishing the aforementioned local preference ordinance. Measurable benefits include the increase in income as well as the additional jobs supported by the policy, increased sales that businesses experience when families react to increases in their disposable income, and increased sales tax revenues. Measurable costs include the direct costs of the local preference ordinance to the City of Fresno resulting from higher contract costs, as well as

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<sup>1</sup> For a more technical description of the multiplier effect, see the Appendix.

the indirect costs to taxpayers who are ultimately responsible for City expenditures.. In other words, this study examines the impact of additional expenditures by the City of Fresno in the local economy measured in four different areas: 1) additional labor income, 2) additional output (sales), 3) the number of jobs that the City supports directly and indirectly, and 4) the additional local and state tax revenue generated by additional City expenditures. Figure 1 illustrates the conceptual framework of this report.

**Figure 1: Conceptual Framework**



The merits of the proposed local preference ordinance are investigated using detailed information about the interactions between firms, industries, and social institutions within the Fresno City economy to quantify the impact of the ordinance in terms of output, income, employment and tax revenue. The main tool utilized in this study is the IMPLAN input-output system, which allows users to build economic models to estimate the impacts of economic changes in their states, counties, or communities. For this analysis, the economic change—and driver of the model—is the increased amount of dollars locally spent by the City of Fresno. The impacted area is the City of Fresno.<sup>2</sup>

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<sup>2</sup> For a more complete description of the IMPLAN system and its application to this analysis see the Appendix.

### **3. Data and Main Assumptions**

All data used in this economic impact study are for the 2005 and 2006 fiscal years and were provided by the office of Fresno City Councilmember Mike Dages. In the 2005 fiscal year, 65 formal bids were awarded by the City of Fresno for a total of \$67,883,306. Of these 43 were public works projects for a total of \$56,246,276, 21 were product bids for a total of \$11,237,626 and one was an RFP for a total of \$199,404. Local vendors received 69% of the bids with a value of \$46,701,482.

In the 2006 fiscal year, 61 formal bids were awarded by the City of Fresno for a total of \$54,511,149. Of these 42 were public works projects for a total of \$27,182,832, 15 were product bids for a total of \$8,510,898, four were RFPs for a total of \$18,813,418. Out of this total, 67% of the bids were awarded to local vendors for a total of \$36,522,469.

Given the available data, it is impossible to determine how many bids would be won by local bidders if the local preference ordinance in the City of Fresno was implemented. Therefore, this study estimates the economic impact of the local preference ordinance under three different scenarios. 1) Maximum impact: All bids are won by local bidders if the local preference ordinance was implemented. 2) Intermediate impact: 50% of the currently awarded bids to non-local vendors are won by local bidders if the local preference ordinance was implemented. 3) Minimal impact: 25% of the currently awarded bids to non-local vendors are won by local bidders if the local preference ordinance was implemented. Under each scenario it is assumed that the local bid is fully 5% more expensive than the non-local bids. This assumption will likely result in an upward bias in both costs and benefits, although the bias should be slightly smaller for benefits due to the nature of the multiplier effect.

Data reported implies that \$20,981,824 was awarded to non-local bidders in FY 2005 while \$17,988,680 was awarded to non-local bidders in FY 2006. Notice that both amounts represent annual leakages from the local economy and therefore do not create a multiplier effect. These are the resources that the local preference ordinance is intended to keep within the local economy which will in turn result in increased economic activity in the form of additional sales, jobs, income and ultimately tax revenue. Since two years of data are available, the average from the two years will be used. Thus, for the purposes

of this study, it is assumed that \$19,485,252 is awarded to non-local bidders annually in the City of Fresno.

#### **4. Cost Estimation**

Estimating the additional costs of the local preference ordinance is straightforward under the three scenarios proposed. Since the cost of the projects must be incurred by paying to either local or non-local bidders, the amount awarded can increase by a maximum of 5% if the local preference ordinance is approved. Therefore, the additional costs under each scenario are as follows: \$974,262 for the maximum impact scenario, \$487,131 for the intermediate impact scenario, and \$243,565 for the minimal impact scenario. Undoubtedly, this extra cost implies that the city may not be buying from the lowest cost or most efficient supplier. Therefore, if contract prices increase, the city will have to decide among cutting services, raising taxes to pay for the higher contract costs or some combination of the two. However, the costs of the ordinance must be weighed against its benefits to have a complete assessment of the potential impact of the local policy.

It is possible that there are additional costs whose estimation is beyond the scope of this report. For example, many states have enacted reciprocal preference laws wherein an additional percentage is added to out-of-state vendors when that state has a local preference law. Generally the percentage added to the out-of-state vendor's bid is determined by the magnitude of the bid preference in the other state. The idea is to protect local vendors from out-of-state competition when the other state discriminates against local vendors. If reciprocal preference laws become pervasive at the state or local level, the result will be higher prices for all consumers—governments, households, and consumers. Also, granting a preference for local vendors has the effect of increasing demand for those vendors' goods and services. If sales to local government comprise a large fraction of a particular vendor's business, then this increased demand may result in higher prices to other consumers within the region. Given the data available, we have not estimated the potential costs of these outcomes although our expectation is that the impact would be small or negligible.

## 5. Benefits estimation

Estimating the benefits of the local preference ordinance is a bit more complicated. The amount awarded to local bidders (and therefore the additional resources spent locally) will be larger as a result of the local preference ordinance. Thus, the increased economic activity will depend on the scenario under consideration. The additional amounts that would be spent locally under each scenario are as follows: \$20,459,514 for the maximum impact scenario, \$10,229,757 for the intermediate impact scenario, and \$5,114,878 for the minimal impact scenario. These additional resources spent in the economy of the City of Fresno generate additional sales and income for local firms and residents. The economic ripple effect can also generate new jobs in the industries positively affected. That is, the local preference ordinance can also create a few jobs in industries not directly affected by it. The potential economic impact of the local preference ordinance is presented in Table 1.

**Table 1: Economic Impact of the Local Preference Ordinance: Three Scenarios**

<b>Maximum Impact</b>					
	<b>Direct</b>	<b>Indirect</b>	<b>Induced</b>	<b>Total</b>	<b>Multiplier</b>
Output	\$20,459,514	\$5,170,237	\$7,583,324	\$33,213,075	1.62
Income	\$8,524,208	\$2,112,433	\$2,626,667	\$13,263,308	1.56
Employment	179	54	84	317	1.77

<b>Intermediate Impact</b>					
	<b>Direct</b>	<b>Indirect</b>	<b>Induced</b>	<b>Total</b>	<b>Multiplier</b>
Output	\$10,229,757	\$2,585,119	\$3,791,662	\$16,606,538	1.62
Income	\$4,262,104	\$1,056,217	\$1,313,334	\$6,631,655	1.56
Employment	90	27	42	159	1.77

<b>Minimal Impact</b>					
	<b>Direct</b>	<b>Indirect</b>	<b>Induced</b>	<b>Total</b>	<b>Multiplier</b>
Output	\$5,114,878	\$1,292,559	\$1,895,831	\$8,303,268	1.62
Income	\$2,131,052	\$528,108	\$656,667	\$3,315,827	1.56
Employment	45	13	21	79	1.76

The impact analysis under the maximum impact scenario shows that the additional \$20.45 million spent by the City of Fresno could produce a total of \$33.21

million in terms of output. Output is measured by the total value of purchases by intermediate and final consumers. Therefore output can also be thought as a value of sales, plus or minus inventory. Under this scenario, additional expenditures could support a total of 317 jobs in the City of Fresno. The employment multiplier, derived by dividing total jobs by the number of direct jobs, is 1.77. The total effect in terms of labor income created could amount to \$13.26 million. Labor income includes salary, wage and proprietor income, which directly impact people's spending capacity.

Under the intermediate impact scenario the additional \$10.22 million spent by the City of Fresno could produce a total of \$16.60 million in terms of output. Under this scenario, additional expenditures could support a total of 159 jobs in the City of Fresno. The total effect in terms of labor income created could amount to \$6.63 million. Finally, under the minimal impact scenario the additional \$5.11 million spent by the City of Fresno could produce a total of \$8.30 million in terms of output. Under this scenario, additional expenditures could support a total of 79 jobs in the City of Fresno. The total effect in terms of labor income created could amount to \$3.31 million.

Additional resources spent in the economy of the City of Fresno generate additional sales and income for local firms and residents, which subsequently lead to further spending and income in an economic ripple effect. This additional spending and income can also generate additional tax revenue. Table 2 shows the tax impact for the intermediate impact. IMPLAN does not produce separate reports for the state and local government. Thus, these estimates include total estimated tax revenue for both levels of government. To obtain the tax impact under the maximum impact scenario, the estimates presented in the table must be doubled (to reflect the fact that 100% of bids are won by local bidders) and to obtain the tax impact under the minimal impact scenario, the estimates presented in the table must cut by half (to reflect that only 25% of the currently awarded bids to non-local vendors are won by local bidders).

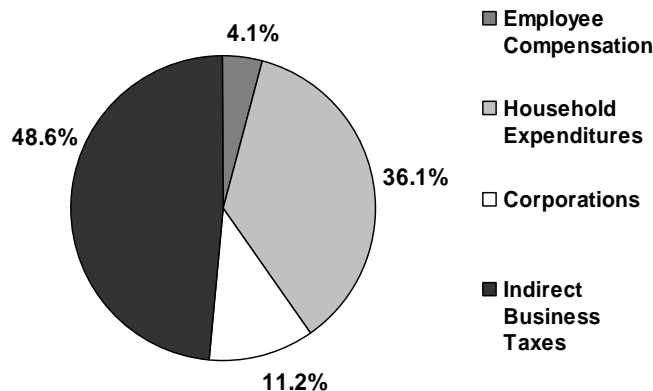
**Table 2: Tax Impact of the Local Preference Ordinance: Intermediate Impact**

Tax Impact: Intermediate Impact						
		Employee Compensation	Household Expenditures	Corporations	Indirect Business Taxes	TOTAL
State and Local Taxes	Corporate Profits Tax			\$28,687		\$28,687
	Dividends			\$64,053		\$64,053
	Indirect Bus Tax: Motor Vehicle License				\$3,115	\$3,115
	Indirect Bus Tax: Other Taxes				\$31,440	\$31,440
	Indirect Bus Tax: Property Tax				\$149,533	\$149,533
	Indirect Bus Tax: S/L NonTaxes				\$18,127	\$18,127
	Indirect Bus Tax: Sales Tax				\$199,272	\$199,272
	Indirect Bus Tax: Severance Tax				\$56	\$56
	Personal Tax: Estate and Gift Tax					
	Personal Tax: Income Tax			\$179,359		\$179,359
	Personal Tax: Motor Vehicle License			\$7,457		\$7,457
	Personal Tax: NonTaxes (Fines- Fees			\$94,361		\$94,361
	Personal Tax: Other Tax (Fish/Hunt)			\$1,176		\$1,176
	Personal Tax: Property Taxes			\$3,802		\$3,802
	Social Ins Tax- Employee Contribution	\$7,977				\$7,977
	Social Ins Tax- Employer Contribution	\$25,877				\$25,877
	<b>TOTAL</b>		<b>\$33,855</b>	<b>\$297,795</b>	<b>\$92,741</b>	<b>\$401,543</b>

**Note:** The tax impact for the maximum impact scenario is obtained by doubling the numbers in the table. The tax impact for the minimal impact scenario is obtained by cutting by half the numbers in the table.

The relative impact contribution to tax revenue from the four components of value added—employee compensation, household expenditures, corporations and indirect business taxes—can be seen in Figure 1. Almost 50% of state and local tax revenue comes from indirect business taxes making the greater contributor. Also significant is the contribution of household expenditures, which contributes in more than 36% to state and local tax revenue.

**Figure 1. Relative Tax Impact Contribution by Component of Value Added**



A deeper analysis of the indirect business taxes category reveals that the main source of revenue for state and local government impacted would be the sales tax, which accounts for almost 25% of the additional total state and local tax revenue generated by the local preference ordinance, if implemented. This result is not surprising when considering that sales taxes are levied as a percentage of the total amount spent at retail stores, which is the sector subject to the largest sales impact.

## **6. Final Comments**

Based on the estimates presented, and purely from the fiscal impact perspective, it seems that a local preference ordinance on the City of Fresno would produce a small negative effect. That is, the ordinance would imply higher expenditures than revenues for the City. For example, under the minimal impact scenario, where the costs for the City would be \$243,565, estimates of the additional sales and property tax amount to only \$178,391 (a marginal deficit of \$65,174). However, when also considering the increased economic activity in the City in the form of additional sales, jobs and income, the ordinance seems more appealing as a policy instrument. Even under the minimal impact scenario estimates indicate that the ordinance could generate as much as \$3.31 million in additional labor income and could support 79 additional jobs. The additional cost to the City of \$65,174 under the minimal scenario seems insignificant when compared to the benefits that the ordinance could bring. Furthermore, the additional \$5.11 million spent by the City under this minimal scenario could produce a total of \$8.30 million in terms of additional sales among local business. In other words, additional dollars spent locally would generate economic activity beyond the value of the initial contract, even if this local contract implies higher costs to the city.

## **Appendix**

### **The Multiplier Effect**

The total impact of the local preference ordinance on the City of Fresno, also known as the multiplier effect, is equal to the sum of three components: the direct effect, the indirect effect and the induced effect. The direct effect is the immediate upshot caused by the additional dollars spent by the City. Due to the interactions between firms, industries, and social institutions that naturally occur within the local economy, the direct effect initiates a series of iterative rounds of income creation, spending and re-spending that result in indirect and induced effects. The indirect effects are changes in production, employment and income that result from the inter-industry purchases triggered by the direct effect. Finally, induced effects arise due to changes in household income and spending patterns caused by direct and indirect effects. Since the total impact of workers' expenditures is a multiple of the initial expenditures, the total effect is expressed as a multiplier effect, that is, the sum of the direct, indirect and induced effects. Therefore, the total impact of additional expenditures by the City on the local economy is larger than the initial expenditures. For example, an output multiplier of 1.5 indicates that for every additional million dollars spent (direct expenditure) an additional 0.5 million dollars is generated within the regional economy. Similarly, an employment multiplier of 1.6 indicates that for each job created by direct expenditure, an additional 0.6 full time jobs are created or supported.

### **The IMPLAN System**

The IMPLAN computer software package consists of procedures for estimating local input-output models using associated databases, which are techniques for quantifying interactions between firms, industries, and social institutions within a local economy. The economic data for IMPLAN come from the system of national accounts for the United States based on data collected by the U. S. Department of Commerce, the U.S. Bureau of Labor Statistics, and other federal and state government agencies. Data are collected for 509 distinct producing industry sectors of the national economy corresponding to the North American Industry Classification System (NAICS). National and county level data are the basis for IMPLAN calculations of input-output tables and multipliers for local areas.